Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109

REPLY COMMENTS OF CARRIERS FOR PROGRESS IN RURAL AMERICA ON PETITIONS FOR RECONSIDERATION

Gerard J. Waldron
Elizabeth H. Canter
COVINGTON & BURLING LLP
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
Tel: 202-662-6000
Fax: 202-778-5444
Counsel to Carriers for Progress in Rural America

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REPLY COMMENTS OF CARRIERS FOR PROGRESS IN RURAL AMERICA ON PETITIONS FOR RECONSIDERATION

Introduction and Summary

Consistent with certain of the petitions for reconsideration received by the Commission in the above-captioned proceedings, the Carriers for Progress in Rural America ("CPRA")[1] urge the Commission to reconsider the Commission's decision in the *USF/ICC Transformation Order* to limit High Cost Loop Support ("HCLS") for rate-of-return companies

[1] CPRA includes the following carriers: Bluffton Telephone Company, MGW Telephone, Inc., Piedmont Rural Telephone Cooperative, Public Service Telephone Company, Smithville Communications, Inc., Star Telephone Membership Corporation, and Valley Telephone Cooperative, Inc.

based on retroactively-applied caps and a flawed regression model.[2] The CPRA further urges the Commission to reexamine the Order to ensure that it provides sufficient and predictable support to accomplish the goal of broadband deployment and in that context to adjust the phase-out of safety net additive support.

I. RETROACTIVE CAPS ON REIMBURSABLE CAPEX AND OPEX ARE FUNDAMENTALLY INCONSISTENT WITH THE COMMISSION'S GOALS OF EFFICIENT INVESTMENT.

CPRA supports the petition for reconsideration filed by the National Exchange Carrier Association, Inc. ("NECA"), the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), and the Western Telecommunications Alliance ("WTA") (together, the "Rural Associations"),[3] along with the petition filed by Accipiter Communications,[4] to the extent that they urge the Commission to reconsider the framework it adopted to limit reimbursable capital expenses ("CAPEX") and operating expenses ("OPEX") on the basis of retroactive, regression-based caps. Of course, CPRA is aware of, and has been participating in, the ongoing rulemaking proceeding that relates to the specific regression methodology and its application using an arbitrary percentile threshold, a process that has been delegated to the Wireline Competition Bureau (the "Bureau"). However, regardless of

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[2] *See In the Matter of Connect America Fund, A National Broadband Plan for Our Future, Establishing Just and Reasonable Rates for Local Exchange Carriers, High-Cost Universal Service Support, Developing an Unified Intercarrier Compensation Regime, Federal-State Joint Board on Universal Service, Lifeline and Link-Up, Universal Service Reform – Mobility Fund*, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket No. 10- 208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov. 18, 2011) ("*USF/ICC Transformation Order & FNPRM*").

[3] Petition for Reconsideration and Clarification of National Exchange Carrier Association, Inc.; Organization for the Promotion and Advancement of Small Telecommunications Companies; Western Telecommunications Alliance, at 9-12 (Dec. 29, 2011) ("Rural Associations Petition").

[4] Petition for Reconsideration of Accipiter Communications, at 10-17 (Dec. 29, 2011); *see also* Comments of United States Telecom Association, at 19-21 (Jan. 18, 2012) ("USTelecom Comments").

how the Bureau resolves these issues on its delegated authority, the framework adopted in the *USF/ICC Transformation Order* cannot be implemented without introducing tremendous uncertainty and unpredictability into the HCLS funding mechanism, thus threatening to reduce HCLS in an arbitrary and capricious manner. The Commission therefore should reconsider the current framework and replace it with a lawful one that (i) is grounded in a clear and articulable determination of reasonableness, unlike the regression analysis and its arbitrary percentile threshold, and (ii) provides carriers the ability to make investment decisions on the basis of reasonably certain levels of HCLS support that are sufficient to support already built network improvements and reasonable operating expenses. At a minimum, the Commission should direct the Bureau to impose a transition period, during which it would perform the regression analysis at least once and divulge the results without using it to reduce support. Such a transition period would also permit the Bureau to test its model before using it to cut support that is needed to provide voice and broadband services to sparsely populated areas of rural America.

A. The Commission Should Reconsider Its Decision To Adopt A Regression Model.

CPRA agrees with the Rural Associations and the Independent Telephone & Telecommunications Alliance ("ITTA") that "the adoption of a regression analysis-based mechanism to limit CAPEX and OPEX recovery is premature in light of the fact that the Commission is seeking comment on the proper methodology for setting caps in the FNPRM phase of this proceeding."[5] The Commission's adoption of regression-based caps "appear[s] to pre-judge the operation of the caps prior to allowing interested parties the opportunity to

[5] Opposition of the Independent Telephone & Telecommunications Alliance, at 7 (Feb. 9, 2012) ("ITTA Opposition"); *see also* Rural Associations Petition, at 9-12.

comment on specific methods to be utilized and to analyze the impacts of such decisions."[6] Not only do applicable administrative law principles require that the Commission afford interested parties the opportunity to comment on the methodology prior to its adoption by the Commission, but it is also a matter of good policy: the Commission would benefit from receiving input from interested parties about alternative methods to achieve the goals of the Commission. Indeed, evidence that has been made a part of the record only since the adoption of the *USF/ICC Transformation Order* weighs heavily in favor of a different approach than the regression analysis adopted by the Commission.[7] For these reasons, the Commission should "reconsider its conclusion to utilize a regression analysis to develop the new caps, and . . . state instead that it will examine a regression analysis approach such as that in Appendix H, subject to adequate notice and comment, before it adopts and implements a particular form of investment or operating expense constraint."[8]

Under the Commission's rules, one basis for reconsideration of an order is reliance on new facts that were not presented to the Commission at the time of decision.[9] Yet that is *precisely* what is happening here, because of how the Commission structured the process. The Commission adopted and implemented regression-based caps *before* it received comments on the specific methodology that will be used to calculate the caps. And it adopted the methodology without seeking comments on the question of whether regression-based caps are rationally linked to imprudent spending decisions. The filings in the related Further Notice should inform the Commission's review of these petitions for reconsideration because they

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[6] Rural Associations Petition, at 8.

[7] *See infra* Section I.B.

[8] Rural Associations Petition, at 10.

[9] *See* 47 C.F.R. §1.106.

illustrate the numerous technical problems and other fundamental flaws with the proposed regression model that have surfaced. These fundamental problems with the capped regression methodology adopted by the Commission will result in arbitrary limits on HCLS and thus call into question the Commission's decision to use the methodology. For example, commenters have identified significant inaccuracies with respect to how the Commission estimated study area boundaries and the mapping of census blocks[10] and have noted that the regression methodology produces anomalous results in many circumstances, raising serious questions about the reliability of the model.[11] As a result of such technical errors, the proposed model is likely to lead to unpredictable support across the board and arbitrary reductions in support for approximately 40 percent of carriers.[12]

Furthermore, there is much uncertainty on whether the set of independent variables identified in the *Order* fully and adequately account for the cost drivers that affect carriers' capital and operating expenses. The Commission has expressed a preference for adopting a methodology that only uses independent variables that are publicly available.[13] However, unless the model accounts for all the relevant cost drivers, the regression model will cause CAPEX and OPEX to be limited in an arbitrary and capricious manner. Carriers simply will not be in a position to make prudent and efficient investment decisions to serve customers in sparsely populated areas on the basis of a regression model that is not predictive of a carrier's

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[10] *See, e.g.*, Initial Comments of National Exchange Carrier Association, Inc.; Organization for the Promotion and Advancement of Small Telecommunications Companies; Western Telecommunications Alliance, at 65-66 (Jan. 18, 2012) ("Rural Associations Initial Comments"); Comments of Nebraska Rural Independent Companies, at 27-33 (Jan. 18, 2012).

[11] Comments of Moss Adams LLP, et al, at 14 (Jan. 18, 2012).

[12] Comments of CPRA, at 3 (Feb. 17, 2012).

[13] *USF/ICC Transformation Order & FNPRM*, at ¶¶ 216, 224, 1083; *see also id.* at Appendix H, ¶ 1.

reasonable costs, as is the case where the model fails to account for highly relevant but perhaps non-public cost drivers and is riddled with technical problems. The Bureau is faced with a dilemma: on the one hand, the Bureau must implement regression-based caps in accordance with the *USF/ICC Transformation Order*; but, on the other hand, the Bureau has received numerous comments identifying a myriad of serious concerns about whether the regression methodology, the inputs into the regression model, and the application of the caps can be implemented in a manner that does not limit HCLS in an arbitrary and capricious manner, much less chill significantly carrier investments in their networks and services.

More fundamentally, as the Rural Associations Petition makes clear, the Commission implemented the proposed framework without any evidence or support for the notion that capital and operating expenses at the 90th (or 85th or 95th) percentile *are* unreasonable or imprudent. Indeed, the only justification offered by the Commission for its proposal to cap reimbursable expenses at the 90th percentile is that "carriers with costs exceeding 90 percent of their similarly-situated peers *may raise questions* about the prudence of such expenditures."[14] The statement that a carrier operating at the 90th (or 85th or 95th) percentile "may raise questions" is a debatable proposition that is not supported by the record. But if the Commission were using the regression methodology simply as a screen to identify certain carriers, we would be engaged in a different debate. It requires a leap of faith -- and not clear, articulable and reasoned decision-making, as required by the APA -- to reach the

[14] *USF/ICC Transformation Order & FNPRM*, at Appendix H, ¶ 12 (emphasis added).

Commission's conclusion that a carrier operating at the 90th (or 95th) percentile *is* acting unreasonably.[15]

In sum, the Commission adopted the proposed regression-based caps without any support for the notion that carriers with costs in the 86th, 91st, or 96th percentile are making unreasonable imprudent investments. As the Rural Associations have stated, "[t]he 90th percentile is an arbitrary figure that has no demonstrable link to a threshold at which costs become unreasonable."[16] Thus, the Commission should reconsider its reliance on a regression methodology to impose caps on capital expenditures and operating expenses.[17]

B. Retroactive Caps Inject Uncertainty And Unpredictability Into HCLS And May Be Unlawful When Applied To Prior Investments.

CPRA agrees with those petitioners that have identified concerns about the retroactive application of caps to HCLS, particularly with respect to investments that have already been made. Even assuming that the regression-based model can be implemented using a non-arbitrary methodology, the retroactive nature of the caps injects substantial uncertainty and unpredictability into the HCLS funding mechanism. Under the *USF/ICC Transformation Order*, reimbursable CAPEX and OPEX are capped retroactively on the basis of the costs incurred by "similarly situated" companies — exogenous factors that are unknown and unknowable to carriers at the time the investment decisions were made. CPRA urges the Commission to

[15] *USF/ICC Transformation Order & FNPRM*, at ¶ 219 ("We conclude that establishing reasonable limits [i.e., a regression-based methodology using 90th percentile] on recovery for capital expenses and operating expenses will provide better incentives for carriers to invest prudently and operate efficiently than the current system.")

[16] Rural Associations Initial Comments, at 66.

[17] *See* USTelecom Comments, at v (calling for further review and study before the regression model would be implemented). At a minimum, the Commission should direct the Bureau to perform a "test run" of the regression analysis, whereby the Bureau would run the regression analysis and divulge the results but should not use it to reduce support in the first year. This "test run" would enable the Commission to identify flaws in the regression model.

reconsider the propriety of the retroactive nature of caps on HCLS, and, at a minimum, impose a transition period so that carriers are not punished for investments that they already have made.

The uncertainty and unpredictability that will result from retroactively imposing caps on the basis of variable factors will make it extremely difficult for rate-of-return companies to make investment decisions and will chill efficient investments in carrier networks and service in high cost rural areas. Even investments that ultimately will be deemed reimbursable given the costs of peer carriers will be chilled. In adopting the framework, the Commission suggested that "companies will have more certainty of support *if they manage their costs to be in alignment with their similarly situated peers.*"[18] The problem with that statement is that carriers will not be in a position to manage costs to align with their peers because they will not know what their peers are doing until it is too late. In any given year, a carrier has no way of knowing whether its costs are within the 90th (or 85th or 95th) percentile of what its peers are spending. Carriers will be asked to provide – and make the investments and expenditures necessary to provide – reliable voice and broadband services throughout their service areas without knowing the amount of HCLS support that they can expect to receive. Put simply, it will be difficult if not impossible for carriers to make economically efficient investments — the Commission's stated goal in adopting this framework.[19] Moreover, with respect to those investments that a carrier deems necessary, the costs of capital are likely to be far greater given the uncertainty that the Commission has injected.

In addition, as the Rural Associations have stated, "the Commission's decision to apply the caps retroactively to investments made prior to the effective date of the Commission's

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[18] *USF/ICC Transformation Order & FNPRM*, at ¶ 221 (emphasis added).

[19] *Id.* at ¶ 288.

implementing rules is . . . fundamentally at odds with the [Communications] Act and basic principles of administrative law."[20] Under the framework adopted by the Commission, on July 1, 2012 or soon thereafter, the Rural Associations have estimated that 40 percent of carriers will learn that they are outliers for a particular category of capital or operating expenses. (While the Commission has indicated that the Bureau should cap expenses over the 85th, 90th, or 95th percentile threshold, the caps are expected to reduce HCLS for approximately 40 percent of carriers — not 15, ten, or five percent — because the caps apply to eleven categories of expenses.[21]) The Commission's decision to penalize companies for past investments is one that lacks fairness. Those carriers will be in the untenable position of already having made capital and operating expenditures in fiber, switches, and other aspects of their networks to provide voice and broadband services on the basis of anticipated HCLS and will thus face a shortfall in the form of substantial reductions in HCLS without the ability to recover remaining costs from small customer bases. The Commission has not proposed a realistic method for carriers to make up this shortfall. Indeed, not only will companies not have the time to increase local rates, they may not have the legal authority required to initiate such increases depending on the regulatory climate in each particular state.[22] Further, such caps — applied to expenses that have already

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[20] Rural Associations Petition, at 9.

[21] *See* Rural Associations Initial Comments, at 71.

[22] CPRA respectfully disagrees with the Commission that carriers, even if they wanted to, would have the lead time necessary to raise consumer rates to cover such expenditures. *See USF/ICC Transformation Order & FNPRM*, at ¶ 219 & n. 351 ("[I]f the costs associated with the capital expenditures exceed their benchmarks, these carriers would have to recover those cots from sources other than USF (such as from their customer base) to ensure a return on that increased investment.").

been incurred — cannot further the Commission's stated objective to encourage companies to "manage their costs *to be* in alignment with their similarly situated peers."[23]

CPRA therefore urges the Commission to reconsider the regression-based caps, at a minimum, with respect to investments made prior to the effective date of the Commission's implementing rules, such as by imposing a year-long transition period before the new framework is implemented. No matter when the methodology is implemented, the framework will inject systemic uncertainty and variability into the HCLS funding mechanism to the detriment of future broadband investment. However, applying the caps to costs that already have been incurred will undermine carriers' reasonable investment-backed expectations, compromising network investments over the next year and sending a chilling signal to future investments.

C. All Carriers Should Be Eligible For Support Increases Based On Support That Becomes Available As A Result Of The Caps.

CPRA further urges the Commission to reconsider the *USF/ICC Transformation Order* to ensure that carriers have appropriate incentives to make efficient network and service investments even if they may be approaching the relevant CAPEX or OPEX cap. Assume arguendo that a reliable and predictable methodology can be developed and implemented such that a company knows how it can efficiently operate within the construct of that methodology. Assume further that this company has an important and legitimate project underway that replaces existing copper with fiber and that the cost recovery can be managed through retail price increases and not HCLS. Under the current capped proposal, if the company moves forward with the fiber deployment and "triggers" one of the eleven caps, it will lose any additional recycled HCLS. Therefore, if the carrier acts in an economically prudent fashion, it will only

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[23] *Id.* ¶ 221 (emphasis supplied on future tense).

move forward with the fiber project if it expects to recover from its end users not only the cost of the new investment, but also the foregone recycled HCLS revenues. Thus, the incentive for all companies will be to reduce their investments, reduce their expenses, and potentially reduce the quality of service and innovative offerings to their customers.

This clearly is bad policy; the current framework will have the impact of reducing investment even where the investment does not rely on universal service support. Moreover, the notion that a carrier whose expenses exceed those predicted by any model by as little as one dollar per month should be deemed a bad actor and ineligible for recycled support is both unreasonable and punitive with respect to those carriers that are endeavoring to enhance their service offerings in sparsely populated areas.

II. THE COMMISSION'S OBLIGATION UNDER THE COMMUNICATIONS ACT IS TO PROVIDE SUFFICIENT AND PREDICTABLE SUPPORT AND ADJUSTMENTS TO THE COMMISSION'S ORDER ARE NECESSARY TO ACCOMPLISH THAT GOAL.

Some parties that submitted comments in response to the petitions seem to view the *USF/ICC Transformation Order* as an immutable text with Talmudic qualities. Comcast Corporation reviews the requests for revisions to the Order filed by US Telecom Association and the Rural Associations and concludes that "such self-serving requests" would "upset[] the balance the Commission has achieved . . . ."[24] Similarly, the National Cable & Telecommunications Association assesses arguments raised by the US Telecom Association concerning the phase down of safety net additive support and other issues, and the Rural Associations' request for reconsideration of the cap on operating and capital expenses and the sufficiency and predictability of support, and finds that these requests variously "border on the ridiculous," and are "the most outrageous," "spurious," "utterly lacking," show an "utter lack of

[24] Comments of Comcast Corporation, at 6 (Feb. 9, 2012). *See generally id.* at 3-6.

seriousness, " and are "beyond the pale." [25] The Commission should ignore this overheated rhetoric and focus instead on its core statutory mission: to ensure that all Americans, have access to telecommunications and broadband services at affordable prices. To accomplish that goal at this stage in the evolution of our communications system, the Commission undertook a massive revision of the economic foundation that underpins our nation's communications infrastructure. It is folly to suggest that in adopting the *USF/ICC Transformation Order*, all 751 pages, the Commission got it exactly right in every detail. The petitions for reconsideration filed by US Telecom Association, the Rural Associations, Accipiter Communications and others raise important concerns that merit adjustment in the *Order* and the rules to ensure that the Commission's attempt at reform is accomplished in a manner that achieves the statutory objectives of the Communications Act.

Specifically, CPRA supports the request of the US Telecom Association that the Commission should not accelerate the phase out of the safety net additive ("SNA") support. There are two arguments in support of a longer phase-out of SNA. First is that carriers have come to rely on these funds over recent years, and given all the other changes in both high-cost support and ICC reform, the rapid loss of SNA to these carriers represents another blow. Second, as ITTA points out, because the Commission maintains this support for competitive ETCs for the five-year period of the phase-out of the identical support rule, the accelerated phase-out for rate-of-return carriers creates a competitive imbalance that fails to treat all market participants equally.[26] CPRA thus agrees with ITTA that the Commission should grant the US Telecom Association request to schedule the phase-out of SNA over a five-year period.

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[25] Comments of the National Cable & Telecommunications Association, at 4-8 (Feb. 9, 2012).
[26] ITTA Opposition, at 11-12.

These various requests to review the *USF/ICC Transformation Order* all fall under a larger rubric, and that is the Commission's obligation to ensure that its policies are up to the task of "ensuring that robust, affordable voice and broadband service . . . are available to Americans throughout the Nation."[27] In supporting targeted revisions to the *Order*, ITTA urges the Commission to "bear in mind that changing the rules mid-course could have a negative impact on the broadband deployment goals it seeks to achieve."[28] This comment is aimed at the SNA phase-out, but its statement has broader applicability. In all aspects of the *Order*, the Commission needs to bear in mind that some of the rule changes could have a negative impact on the broadband deployment it seeks to achieve. As the Rural Associations put it, "[u]nder the reforms in the *Order*, along with those threatened in the FNPRM, few, if any, RLECs will be in a position to advance broadband, and some may not even be able to sustain the DSL-speed broadband they have deployed today."[29]

As the Commission's reconsiders the *USF/ICC Transformation Order* and the comments submitted in this proceeding, the members of CPRA urge the Commission to take these claims seriously and to adjust its rules so that all carriers have predictable and sufficient support to achieve the broadband objectives that the Commission has established.

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For the reasons described herein, CPRA urges the Commission to reconsider its adoption of a framework to impose retroactive caps on reimbursable capital and operating expenditures for rate-of-return companies. At a minimum, the Commission should direct the

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[27] *USF/ICC Transformation Order & FNPRM* at ¶ 1.

[28] ITTA Opposition, at 12.

[29] Rural Associations Petition, at 7.

Bureau to impose a transition period during which carriers will be able to make investment decisions on the basis of the specific methodology that will be used to determine such caps.

Respectfully submitted,

Elizabeth Canter

Gerard J. Waldron
Elizabeth H. Canter
Covington & Burling LLP
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
Tel: 202-662-6000
Fax: 202-778-5444

Counsel to Carriers for Progress in Rural America

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CERTIFICATE OF SERVICE

I, Elizabeth H. Canter, hereby certify that on this twenty first day of February, 2012, a copy of the foregoing was sent via United States mail, postage prepaid, to the following:

Kathryn A. Zachem
Mary P. McManus
Comcast Corporation
300 New Jersey Avenue, NW, Suite 700
Washington, DC 20001

Brian A. Rankin
Andrew D. Fisher
Comcast Cable Communications, LLC
One Comcast Center, 50th Floor
Philadelphia, PA 19103

Rick Chessen
Steven F. Morris
Jennifer K. McKee
National Cable & Telecommunications Association
25 Massachusetts Avenue, NW – Suite 100
Washington, DC 20001-1431

Richard A. Askoff
Teresa Evert
National Exchange Carrier Association, Inc.
80 South Jefferson Road
Whippany, NJ 07981

Stuart Polikoff
Organization for the Promotion and Advancement of Small
Telecommunications Companies
2020 K Street, NW, 7th Floor
Washington, DC 20006

Derrick Owens
Western Telecommunications Alliance
317 Massachusetts Avenue N.E., Suite 300C
Washington, DC 20002

Gerard J. Duffy
Counsel, Western Telecommunications Alliance
Blooston, Mordkofsky, Dickens, Duffy & Prendergast, LLP
2120 L Street NW (Suite 300)
Washington, DC 20037

Patrick Sherrill
Accipiter Communications
2238 W. Lone Cactus Dr., Suite 100
Phoenix, Arizona 85027

Genevieve Morelli
Micah M. Caldwell
ITTA
1101 Vermont Ave., NW, Suite 501
Washington, D.C. 20005

Elizabeth H. Canter